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BEFORE THE PUBLIC UTILITIES COMMISSION

OF THE STATE OF HAWAII

In the Matter of the Application of PUBLIC UTILITIES COMMISSION Instituting a Proceeding to Investigate Implementing a Decoupling Mechanism for Hawaiian Electric Company, Inc., Hawaii Electric Light Company, Inc., and Maui Electric Company, Limited.	)	DOCKET NO. 2008-0274

DIVISION OF CONSUMER ADVOCACY'S

POST-HEARING REPLY BRIEF

AND

CERTIFICATE OF SERVICE

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DIVISION OF CONSUMER ADVOCACY'S POST-HEARING REPLY BRIEF

Pursuant to Schedule of Proceedings amended and restated by the Public Utilities Commission ("Commission") in the Order Approving, With Modifications, Stipulated Procedural Order Filed On January 21, 2009,[1] the Division of Consumer Advocacy, Department of Commerce and Consumer Affairs, State of Hawaii ("Consumer Advocate"), hereby submits the following Post-Hearing Reply Brief ("Reply Brief") in the instant proceeding. As will be discussed below, the Consumer Advocate has generally addressed the merits and supported the positions offered in the Joint Final Statement of Position ("JFSOP") in this proceeding in its post-hearing Opening Brief filed on September 8, 2009 ("Opening Brief") as well as addressed many of the significant contentions in other parties' briefs.[2] Thus, this Reply Brief will not be

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1 In a letter dated August 7, 2009, the Commission approved a motion, which, among other things, amended the due date for opening briefs in the instant docket as September 8, 2009, and the Reply Briefs as due on September 29, 2009.

2 As will be used herein, "Parties" refer to those entities already defined in the Consumer Advocate's Opening Brief.

comprehensive in scope and will focus primarily on certain issues that warrant additional response and those that were introduced in other parties' opening briefs.

I. **INTRODUCTION.**

On September 8, 2009, the Consumer Advocate filed its Opening Brief that sought to explain why the JFSOP, submitted in the instant docket by the Consumer Advocate and Hawaiian Electric Company, Inc. ("HECO"), Hawaii Electric Light Company, Inc. ("HELCO"), and Maui Electric Company, Limited ("MECO") (collectively herein referred to as the "HECO Companies"), represents a reasonably balanced and administratively workable decoupling package that was carefully designed to facilitate the achievement of the regulatory reforms called for in the *Energy Agreement Among the State of Hawaii, Division of Consumer Advocacy of the Department of Commerce and Consumer Affairs, and the Hawaiian Electric Companies,* entered into October 2008 ("Energy Agreement" or "HCEI Agreement"). The Consumer Advocate emphasizes that the JFSOP decoupling package is fully developed and can be immediately implemented upon approval of the proposed Revenue Balancing Account ("RBA") provision and Rate Adjustment Mechanism ("RAM") tariffs.

The proposed RAM framework would initially be implemented in conjunction with decoupling and deferral accounting on a trial basis for each of the HECO Companies, pursuant to predefined rate case filings and RAM implementation schedules. The decoupling of sales volumes from utility revenue collections is proposed to occur upon the implementation of interim rates ordered by the Commission in the pending HECO rate case.[3] The RAM amendments to this decoupled and otherwise "fixed" level of revenues are then to occur soon thereafter, between rate case test years. A similar pattern of MECO and HELCO rate case filings is projected, followed by subsequent RAM revenue adjustments building upon the ordered revenue requirement outcomes of those rate cases.

Provided within the various opening briefs, filed on September 8, 2009, other parties to this docket and the Commission's consultant suggested numerous fundamental changes to the proposed RAM framework that would, in the opinion of the Consumer Advocate, require substantial further analyses and refinements before the changes could be prudently implemented. The JFSOP and RBA/RAM tariffs are the result of a process of rigorous analysis, discussion and negotiation that benefited from the input of the parties to this Docket as well as thoughtful comments and concerns raised by the Commission during the panel hearings[4] and discovery. The Commission should resist approval of any RAM revisions that have not been rigorously defined, specified in detail and analyzed to ensure reasonably balanced results that will meet the just and reasonable needs of both the HECO Companies as well as ratepayers.

Several key objectives are met by the approach taken in the JFSOP, objectives which are critical to assuring full involvement of the HECO Companies in support of the State's efforts to move away from fossil fuels and toward energy independence. These objectives include:

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[3] Docket No. 2008-0083.

[4] The panel hearings were held during the week of June 29, 2009.

- Decoupling of sales volumes from utility profits (using RBA) to avoid any financial impact upon the HECO Companies when electric energy sales decline, which is likely to occur upon installation of customer-sited DG, new renewable resources and increased energy efficiency by consumers.
- After revenue growth is no longer available to offset utility cost inflation between rate cases, formulistic revenue requirement adjustment (via RAM) to avoid annual rate filings which would otherwise be needed to ensure the financial strength of the HECO companies and access to capital on reasonable terms.
- Careful balancing of RAM provisions to adequately replace the need for formal rate cases that could occur on an annual basis with conservatively estimated revenue changes that simulate how revenue requirements would be calculated if a rate case were actually conducted. The RAM revenue changes must be sufficiently large to discourage and replace rate case filings, but not so large as to overstate the actual financial needs of the utilities between test years.
- Administrative simplicity in RBA/RAM mechanism design to minimize controversy and complexity in administration, reducing the overall expense and distraction of frequent rate cases.
- Consumer safeguards in the form of earnings sharing and formal review of RBA/RAM in 2011, to ensure that even a conservatively scoped RAM does not produce unanticipated financial results.

- Risk reduction and the associated savings in required return on equity upon implementation of RBA and RAM, due to improved certainty of timely regulatory recovery of costs and protection against risks generally associated with decreasing sales volume and/or rapidly increasing capital investment needs.

In their opening briefs in this Docket, the Parties state their general support of the conceptual basis for decoupling, including to varying degrees support for the RBA and RAM approaches set forth in the JFSOP. The Consumer Advocate greatly appreciates the effort and contributions of the Parties and we relied upon many of ideas and concerns raised by the Parties in development of the JFSOP. However, as can be expected when so many parties are invited to provide input on a topic of this complexity, the record now contains a multitude of diverse alternative decoupling recommendations and conditions that the Commission will need to carefully analyze. The Consumer Advocate suggests that the framework best employed for the Commission's analysis of decoupling alternatives is the bullet point list of design criteria described above. When these screening tools are employed, the JFSOP recommendation will emerge as superior to the proposals of the other parties which are not fully developed and cannot be reasonably expected to meet the objectives of an effective and balanced decoupling mechanism.

The issues and arguments presented by the Department of Business, Economic Development, and Tourism ("DBEDT"), Haiku Design and Analysis ("HDA"), Blue Planet Foundation ("Blue Planet"), Hawaii Renewable Energy Alliance ("HREA") and Hawaii Solar Energy Association ("HSEA") (collectively the "Other Parties"), are addressed by the Consumer Advocate in this document only where they are significantly contrary to a position being taken by the Consumer Advocate. The general subject matters where such remaining contrary positions exist include:

- Revisions or limitations to the proposed RAM methodologies.
- Performance conditions to RAM implementation.
- ECAC modifications.
- Docket continuation, interim/conditional implementation, new studies.

These major topics will be addressed in individual sections of the Consumer Advocate's Reply Brief. Additionally, the HECO Companies have proposed four new decoupling alternatives in their opening brief that do not comport with the JFSOP methodologies. This Reply Brief will explain the Consumer Advocate's response to each of these new alternative proposals that are said to be acceptable to the HECO Companies, including:

- Simplification of the separate RBA residential/commercial accounting into a single account.
- Credits in the event plant additions included in the rate base RAM are later disallowed.
- Addition of a service quality crediting mechanism.
- Modification of the rate base RAM, to add quarterly filings and rate adjustments for major plant additions only after they achieve commercial operation.

II. RAM REVISIONS AND LIMITATIONS PROPOSED BY THE PARTIES.

The DBEDT opening brief is critical of the RAM proposal, asserting that RAM "shifts all risks from the utility to ratepayers" and may "overcharge the customers during these economic times."[5] DBEDT then introduces a series of proposed modifications to the RAM tariff that are characterized as "consumer safeguards" and that include a cap of total permitted rate increases, maximum bounds on the GDPPI index, percentage caps on baseline capital projects, exclusion or limitation of major capital projects and/or percentage caps on major capital projects.[6] There are no specific percentage or dollar values recommended by DBEDT in connection with these RAM limitation proposals, presumably leaving quantification issues entirely to the Commission's discretion. Later in its opening brief, DBEDT also recommends disallowing all labor cost increases in calculating RAM revenue adjustments.[7] These proposals are not explained or justified in the context of how they might better achieve the objectives of protecting the financial strength of the utilities or their ability to support the State's energy goals while avoiding annual rate cases. Supporting such proposals will be likely to undermine the primary goals that are being sought since many of the HCEI commitments, to which DBEDT is a signatory, require significant capital investments by the utility companies and unjustified disallowances would impair the utility companies' ability to fund the necessary investments.

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5 DBEDT opening brief, p.17.

6 Id. p. 18 - 19.

7 Id. p. 30.

The RAM proposal contained within the Consumer Advocate and HECO's JFSOP includes conservatively quantified adjustments for known labor cost increases based upon union wage contract provisions, less an offset for assumed productivity improvements.[8] The proposed RAM in the JFSOP starts with only Commission approved income statement and rate base inputs, and then applies simplified and conservatively quantified factors to only the largest and most important determinants of the utilities' costs to provide service.[9] In contrast, the DBEDT alternative proposals would arbitrarily exclude known cost changes or would otherwise reduce RAM revenue adjustments with arbitrary caps or percentage limits. If the RAM is not specifically designed to reliably estimate how utility costs are changing between test years, there is no purpose served by implementing a RAM because it will fail to address its intended purpose. With no explanation by DBEDT as to how arbitrarily constrained RAM revenue adjustments can either avoid future rate cases or insure the financial viability of the HECO Companies between rate cases, there is no support in the record for these changes and they should be rejected.

Beyond its own proposals, DBEDT also addressed the alternative revenue adjustment mechanisms that were suggested in the Commission's post hearing information requests to the Parties (IRs 3a, b, and c), characterizing these alternatives as "examples of 'targeted' revenue adjustment mechanisms [that] are variants of the HECO/CA RAM proposal."[10] DBEDT indicates that, "each of these mechanisms will

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8 Consumer Advocate Opening Brief; p. 19.

9 Id. pp. 18-20.

10 DBEDT opening brief; p. 37.

most likely result in a lower rate increase impact relative to the HECO/CA RAM proposal" and states that, "[t]he downside of these targeted revenue adjustment mechanisms is the difficulty of determining the costs that qualify to be included under these categories." On this subject, the Consumer Advocate shares DBEDT's concerns about vaguely defined includable cost categorizations which are not readily isolated on the utilities' books and would be an administrative nightmare to quantify, as more fully explained in the "Partial RAM Alternatives" section of the Consumer Advocate's Opening Brief.[11] The Consumer Advocate, however, does not share the apparent DBEDT opinion that, "[a]dopting any one of these targeted revenue enhancing mechanisms requires a clear and transparent definition and guidelines from the Commission on what costs qualify under each classification" can readily serve, ".... to ensure that there is no double counting or double recovery of any cost item." The devil is very much in the details in administering any rate adjustment that does not apply crisply clear definitions and simple calculations to readily isolated and transparently quantifiable cost categories, particularly when extensive Commission and Consumer Advocate analysis time and audit resources are not available to carefully regulate any complex RAM accounting analyses in support of rate adjustments that are intended to be quickly and efficiently implemented. The Consumer Advocate is strongly opposed to any proposed RAM framework that seeks to employ accounting definitions and account classifications that are not part of the Commission required use of the NARUC Uniform System of Accounts as is followed by the HECO Companies.

11 Consumer Advocate Opening Brief; pp. 25-26.

DBEDT, HDA and Blue Planet all comment upon the Revenue Per Customer ("RPC") methodology as an alternative to the RAM tariff. The Consumer Advocate will not repeat its concerns with RPC that were set forth in a section of its Opening Brief.[12] It should be observed, however, that the chief proponent of RPC in the panel hearings was HDA, and this party is now recommending approval of the proposed RAM (rather than RPC) on an interim one year pilot program basis.[13] HDA also includes a candid admission that, "HDA's examination of the RBA decoupling mechanism was rigorous. By contrast, HDA's examination of the details of the proposed RAM was substantially less thorough" and then notes later in its opening brief that, "The HDA RPC Mechanism is not designed to increase the magnitude of collected revenues or the accuracy of the recovery of **revenue requirements** between rate cases compared to existing methods.[footnote omitted, emphasis in original document]"[14] On this point, the *Consumer Advocate views these disclaimers as sufficient for the Commission to discard* RPC as unacceptable and submits that every effort should be made to accurately yet conservatively simulate the changing revenue requirement of the utilities through the rate adjustment formula. This is the only way to proceed if the RAM is to succeed in

12 Id. pp. 22-24.

13 HDA Opening Brief; p. 7. RPC is offered only as an alternative if the Commission does not implement RAM. HSEA joined HDA in support of RAM implementation as a pilot in its filed Joinder to Blue Planet's Post-hearing Brief. HREA in its Joinder to the HDA Brief appears to continue to support the RPC approach as "simpler and easier to implement," even though HDA is not advocating immediate approval of RPC.

14 HDA Opening Brief; pp. 5, 24. In footnote 21, HDA states that the RPC mechanism serves "...a distinctively different purpose that he RAM which is intended to increase the magnitude of revenue between rate cases, more accurately track company expenses and reduce regulatory lag associated with revenue recovery for capital projects."

replacing annual rate cases while securing the financial stability and health of the utilities.

DBEDT is also critical of RPC and its advocacy includes support for decoupling with a modified RAM (rather than RPC) that includes expanded consumer safeguards and service reliability and renewable performance linkages.[15] At page 36 of its opening brief, DBEDT notes that, "[f]or a utility with an increasing customer base, RPC may be an effective mechanism for a timely cost recovery of the increases in costs, <u>assuming that the increases in costs are due mainly to the increase in the number of customers served</u>." [emphasis added] This simplistic and unproven assumed correlation between overall utility costs and the number of customers being served is the Achilles heel of the RPC method and reveals why it cannot be expected to accurately replace annual rate cases to provide needed revenue adjustments for the HECO Companies. For its part, Blue Planet states a concern that, "[i]ncorporating a RPC, either with or without reset, with any RAM may result in double recovery of certain revenue requirement items."[16] For all of the reasons stated in the Consumer Advocate's Opening Brief, as echoed by the Other Parties' Briefs as noted herein, the RPC approach is fatally flawed and should not be seriously considered by the Commission.

Blue Planet notes in its opening brief support for, "adoption of the Joint Decoupling proposal" and offers several comments concerning the RAM calculation that illustrate an understanding of the need for and proper objectives of the RAM.[17] Blue

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15 DBEDT opening brief; pp. 54-55.

16 Blue Planet opening brief; p. 16.

17 Id. pp. 1, 5, 10.

Planet states that, "...any inter-rate case revenue enhancement should reflect, as much as possible, the methodology used by the Commission in a traditional rate case to determine a particular component of an electric utility's revenue requirements."[18] This is precisely what the proposed RAM is designed to do. Blue Planet also observes that, "[r]egulatory lag should be reduced to the extent possible" and, "[t]he number and frequency of rate case filings may increase to the extent various revenue requirement components are excluded from any RAM adopted in this proceeding."[19] Blue Planet also observes that a "comprehensive RAM" tends to remove regulatory lag which may enable a moratorium on future rate case filings and that "ROE sharing as proposed in the Joint Decoupling Proposal" is appropriate and should be "incorporated into any RAM adopted by the Commission." Blue Planet also recognizes that O&M costs incurred for HCEI-related items are to be separately recovered through a Renewable Energy Infrastructure ("REIS") or Clean Energy Infrastructure ("CEIS ") surcharge process and not through the RAM.[20] These are all elements of the RAM provision set forth in the JFSOP and the Consumer Advocate appreciates Blue Planet's consideration and endorsement of these terms, recognizing that, "[t]he RAM should be implemented to improve and then maintain the HECO Companies' financial integrity."[21] Two proposed conditions are attached to RAM approval by Blue Planet; a recommendation that RAM/RBA adjustments be calculated and applied on a total company rather than

18 Id. p. 10.

19 Id. p. 11.

20 Id. pp. 11-12.

21 Id.

customer class basis and a recommendation that the authorized ROE for the HECO Companies be reduced to account for the transfer of significant amounts of risk from the utilities to their ratepayers with RAM in place.[22] The Consumer Advocate fully supports consideration of decoupling-produced risk reduction in the determination of authorized ROE in the pending and future rate cases of the HECO Companies. The proposed simplification of the RBA Residential and Commercial sub-accounts is addressed below and is not objectionable to the Consumer Advocate.

III. PERFORMANCE CONDITIONS TO RAM.

In its Opening Brief, the Consumer Advocate summarized and explained the various Consumer Safeguards that were proposed in connection with the RBA/RAM recommendation in the JFSOP.[23] Among the safeguards is a requirement that the entire decoupling mechanism be subject to formal review and a showing by the HECO Companies in the next HECO rate case to determine whether the mechanism should be continued or modified, including the filing of a report of the achievements and status of the HECO Companies' HCEI performance that is to be an integral part of that formal review. This approach was determined to be appropriate because many of the factors impacting the pace at which customer-sited distributed generation and other renewable resources can actually be deployed are not controllable by the utility and because it is not presently possible to specify detailed performance expectations given several

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22 Id. pp. 12-15.

23 Consumer Advocate opening brief; p. 32.

ongoing proceedings before the Commission that will influence the rate of deployment of renewable resources.

Other Parties are less reticent than the Consumer Advocate regarding early HCEI performance target specification. DBEDT and Blue Planet suggest that HECO's ability to recover its costs through RAM, rather than annual rate cases, should be conditioned upon performance measures that the Commission would set and apply immediately. For example, Blue Planet argues that a Performance Incentive Mechanism ("PIM") that it has developed should be applied as a *quid pro quo* in return for RAM alternative ratemaking. Even though Blue Planet acknowledges that the HECO Companies are legally obligated to comply with the HCEI commitments they have made as a result of Act 155, it argues that "absent a PIM the Hawaii RPS law provides no incentives."[24] Blue Planet's proposed PIM would calculate and apply a Clean Energy Utilization ("CEU") numerator to a Total Energy Requirements denominator to calculate a CEU factor that would be compared to "Target" values that are proposed in Table 3 of Blue Planet's opening brief, with further translation into potential multi-million dollar rate adjustments to the RAM results (as set forth in Table 4) for each of the HECO Companies when the Target values are under or over-achieved. Blue Planet recommends that the PIM calculation should be symmetrical, so as to reward the HECO Companies with higher rates when the PIM target is exceeded and punish the Companies HECO with lower rates and returns when the future PIM targets that are recommended are not achieved.[25]

24 Blue Planet opening brief; pp. 17-20.

25 Id. p. 24.

No financial or renewable market analysis is provided by Blue Planet in support of its newly proposed PIM Targets or RAM Rate Adjustments, but we are offered the suggestion that, "[t]he maximum upward/downward incentive adjustment to annual RAM rate change would be equivalent to approximately plus or minus 0.5% ROE for each of the HECO Companies."[26] Beyond the obvious problems with implementing a financial significant reward/penalty device first conceived and presented in an opening brief, the Commission should consider the process issues created by potentially contentious performance measurement and decoupling adjustments. Within its opening brief, Blue Planet notes that the Commission has already established its own penalty of $20 per megawatt hour when the utility falls short of the RPS.[27] Also noted by Blue Planet is the fact that, "[t]he Commission may, however, in its discretion waive any applicable penalties if it determined the electric utility company is unable to meet the RPS due to events or circumstances 'beyond the usual control' of the utility." It is this same reasonable opportunity to consider and properly weigh "circumstances" and what is "beyond the control of the utility" that caused the Consumer Advocate and the HECO Companies to schedule the formal review of decoupling <u>in the next rate case</u> as a forum, with discovery and hearings as necessary, to provide a thorough review of the HECO Companies' performance. Blue Planet's recommended PIM targets and self-actuating RAM rate adjustments, with no mechanism for Commission consideration or potential waiver of any resulting penalties, is not consistent with the process already determined by the Commission to be appropriate for RPS shortfall penalties.

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26 Id. p. 25.

27 Id. p. 3. By footnote, Blue Planet references the Commission's December 19, 2008 Order in Docket No. 2007-0008.

According to the DBEDT opening brief, "[l]inking HECO's proposed RAM mechanism to performance metrics related to Hawaii's energy goals it has obligated itself to help achieve, is necessary, prudent, and in the public interest.[28] DBEDT had proposed specific performance target metrics in its FSPOP that was filed in May, but has now amended these targets to recognize that HECO's performance should not be judged based upon any linkage to, "...things that are not yet approved by the Commission (i.e., feed-in tariffs and PV Host Program)...." [footnote omitted] The DBEDT amended target performance goals include three Net Energy Metering ("NEM") objectives which are specified as Megawatt values with proposed weights for each of the proposed target MW values, using the same targeted MW values for the years 2010 and 2011.[29] No explanation is provided by DBEDT as to how the target values, weightings or range of potential "Allowed RAM" percentage values were derived and, as with the Blue Planet PIM proposal, there is no process set forth by DBEDT to allow the Commission to consider and waive any penalties that may not be appropriate. As a final matter, DBEDT indicates at page 23 of its opening brief that, "except for the HECO Companies, there is general support among the Parties to link the HECO proposed RAM to some performance metrics based on the commitments made in the Energy Agreement." However, this representation does not accurately represent the Consumer Advocate's position on this matter.

As noted previously, the Consumer Advocate supports a comprehensive review of HECO performance relative to the HCEI objectives as part of the formal analysis of

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28 DBEDT opening brief; p. 19.

29 Id. pp. 20-21.

decoupling continuation or modification in the 2011 HECO rate case, when more can be known about reasonable expectations for HECO performance. HDA appears to agree with the Consumer Advocate and HECO that it is premature at this time to reasonably condition RAM revenue adjustments to measurement of HECO's performance in connection with implementation of the Energy Agreement. At page 21 of its opening brief, HDA states, "If performance measures are to be implemented in this proceeding they need to be characterized in substantially more detail than what is currently on the record and they need to be appropriately examined." To accomplish this goal, "HDA recommends that this proceeding should be continued for consideration of several matters. Further examination of appropriate performance measures could be taken up in the continued proceedings." The Consumer Advocate does not support continuation of this Docket, as more fully explained below, and believes that the HECO Companies' performance relative to the elements of renewable and energy efficiency they control should be fully and formally considered in the 2011, or applicable, test year review of decoupling, as set forth in the Joint FSOP.

IV. PROPOSED ECAC MODIFICATIONS.

As a result of the proposed decoupling mechanism, the Parties propose the ECAC be modified, but differ on the scope of the proposed pass-through formula that should be used in the modified ECAC. The ECAC modifications jointly proposed by the HECO Companies and the Consumer Advocate provide for a partial pass-through formula within a range, or a "deadband," around a fixed heat rate that holds the HECO Companies' management responsible for maintaining the thermal efficiency of generating resources. The Other Parties propose that the ECAC be modified to become a full pass through mechanism.[30]

Under either the joint proposal by the HECO Companies and the Consumer Advocate, or the full pass through mechanism proposed by the Other Parties, the ECAC calculation will be the same as long as the HECO Companies perform within the heat rate deadband around the fixed heat rate. The two proposals differ on how the ECAC calculation will be made when the HECO Companies perform outside of the heat rate deadband. The deadband range around the heat rate target jointly proposed by the HECO Companies and the Consumer Advocate, by design and supported by analysis, will reasonably accommodate all anticipated changes in sales level and addition of smaller intermittent, renewable resource additions between rate case filings. Addition of larger resources will trigger a reevaluation and redetermination of the heat rate target under the circumstances set forth in the joint proposal.[31] Therefore, with respect to the ECAC calculation, the difference or distinction between the two ECAC proposals only comes into play when the HECO Companies' performance differs from, and/or does not meet, reasonable expectations.

In a scenario where HECO does not perform as well as reasonably as expected and the actual heat rate exceeds the deadband around the fixed heat rate and assuming that there have been no significant changes in the resources used by HECO,

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30 DBEDT also proposes that, if the Commission does not eliminate the fixed heat rate from the ECAC calculation, the heat rate used in the ECAC calculation should be modified to exclude consideration of energy for losses and unaccounted for energy. DBEDT's proposed modifications to the fixed heat rate are discussed later in this section.

31 The development of the target heat rate involves production simulation modeling that takes into account the spinning reserves (or operating reserves) needed to accommodate and integrate intermittent, renewable resources on HECO's system.

this situation would occur when HECO has not operated as efficiently as is reasonable under the existing circumstances, the Consumer Advocate is concerned about ratepayers being reasonably protected in this situation and seeks to put the risks of performing less efficiently on HECO. This differs from the full pass through mechanism proposed by the Other Parties, where the ratepayers will bear the full cost consequences of HECO's performance not meeting reasonable expectations, even when that performance has no relationship to the addition of renewable resources. The full pass through mechanism proposed by the other parties would clearly shift the consumer protection risks, and burden of seeking cost recovery, from the HECO Companies to the Commission and Consumer Advocate requiring after the fact analyses, audits, investigations and reviews after the ECAC calculated rates have been applied and monies collected from ratepayers. Indeed, without the existence of a target heat rate and band for reasonable performance, it will be difficult for either the Commission or the Consumer Advocate to know when such efforts should be initiated.

Next, take the flip side of the above example – HECO performs better than the deadband around the target heat rate. Again the two ECAC proposals differ with HECO retaining the benefits of its better than reasonably expected performance under the joint HECO Companies and Consumer Advocate proposal, versus the pass through of such better than reasonably anticipated benefits to ratepayers under the Other Parties' full pass through proposal. One would have to question the motivation or incentive for the HECO Companies to pursue better than reasonably expected performance especially if achieving such would require an expenditure of additional efforts or monies by the HECO Companies. *On the other hand, there is no question that the target heat rate,* with the proposed deadband, provides the HECO Companies an incentive to investigate and pursue efficiency improvements, to do better, and to capture funds to offset the additional cost and to reward the additional efforts needed to achieve better than reasonably expected performance. While it might be argued that any utility company should investigate all reasonable options to improve and make more efficient its operations, such an expectation should certainly be tempered by the regulatory experience. That is, if regulated industries could reasonably be expected to put the public interest first and foremost, such as making its operations as efficient as possible to reduce the cost of service and reduce consumption of resources, the need for regulation would be diminished.

Examples of additional cost and efforts by the HECO Companies to improve efficiency include expediting maintenance on an efficient unit to reduce scheduled down time may require paying an added premium for parts and services, or paying overtime to shorten maintenance periods, or provide staffing for operating efficient units. It is not reasonable to expect that the HECO Companies would be induced to find and pursue such opportunities under a full pass through mechanism, as it would under an ECAC with a heat rate target. Nor is it reasonable to expect either the Commission or the Consumer Advocate to be able to uncover such opportunities that should have been considered and pursued by the HECO Companies, regardless of the additional reporting auditing requirements that should be required if a full pass through mechanism is adopted. Improvements in the HECO Companies' performances result in reduced fossil fuel consumption when efficiency improves, and allows the opportunity for setting a lower heat rate target during the next HECO, or applicable HECO Companies, rate case.

Retaining the fixed heat rate in the ECAC calculation and incorporating a deadband range reflects a symmetrical regulatory measure that would allow the HECO Companies to retain the benefits of greater than reasonably expected efficiencies as well as requiring the HECO Companies to absorb the costs associated with less than reasonably expected inefficiencies. There may be concerns that, from the ratepayers' perspective, the HECO Companies should not be allowed to retain such benefits, or there may still be concerns that if the HECO Companies are required to absorb such costs, that will be sufficient incentive to "stonewall" the addition of intermittent, renewable resources. Such concerns, however, need to take into account the following considerations. First, any benefit or costs derived from results outside of reasonable expectations should be temporary in nature. That is, if any of the HECO Companies achieve greater than reasonably expected efficiencies, those efficiencies can and will, if reasonable, be included in the determination of the next fixed heat rate to be used for that company. And, as already mentioned, if system efficiencies are less than anticipated due to the addition of small or large renewable resources, intermittent or not, those additions will be considered in the determination of the next heat rate. However, if the losses are as a result of system inefficiencies unrelated to the addition of renewable resources, the Company will have to justify why it is reasonable to expect customers to have to pay for such inefficiencies when the heat rate is revisited at the next appropriate review.

The Other Parties proposing a full pass through mechanism have not addressed Act 162 considerations, or whether such a mechanism would meet with the Act's requirements. It is not certain how a full pass through mechanism could comply with Act 162, particularly with regards to the risk sharing aspects discussed above. On the other hand, it appears that the Commission has previously found the ECAC calculation with the fixed heat rate provisions generally satisfies the requirements of Act 162.[32]

Some of the parties suggest the use of a fixed heat rate in the ECAC calculation provides a disincentive for the HECO Companies to accommodate an increasing supply of intermittent, renewable generation if doing so requires the HECO Companies to carry higher amounts of spinning reserves (or regulating reserves) that cause a higher heat rate. Under the joint HECO Companies and Consumer Advocate ECAC proposal, the target heat rate is determined based on production simulation analysis that includes

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[32] On June 2, 2006, the Governor of Hawaii signed into law Act 162 (2006 Session Laws of Hawaii), which amended Hawaii Revised Statutes ("HRS") Section 269-16. Act 162, in part, required that any automatic fuel adjustment clause to meet certain criteria, which are as follows:

(1) Fairly share the risk of fuel cost changes between the public utility and its customers;
(2) Provide the public utility with sufficient incentive to reasonably manage or lower its fuel costs and encourage greater use of renewable energy;
(3) Allow the public utility to mitigate the risk of sudden or frequent fuel cost changes that cannot otherwise reasonably be mitigated through other commercially available means, such as through fuel hedging contracts;
(4) Preserve, to the extent reasonably possible, the public utility's financial integrity; and
(5) Minimize, to the extent reasonably possible, the public utility's need to apply for frequent applications for general rate increases to account for the changes to its fuel costs.

The Commission sought to consider the ramifications of Act 162 on HECO's ECAC in Docket No. 04-0113. However, due to the advanced stage of Docket No. 04-0113, the parties to that docket indicated that it might be more appropriate to fully consider all issues in a subsequent rate case and those arguments can be found in Docket No. 2006-0386, wherein a final decision and order is still pending. In Decision and Order No. 24171, filed on May 1, 2008 in Docket No. 04-0113, however, the Commission indicated that the record contained information that was relevant to all of the issues raised by Act 162 (other than HECO's ability to mitigate the risk of sudden or frequent fuel cost changes) and found that the continuation of the ECAC was reasonable and benefited customers. (See pages 29 – 30).

integration of known and reasonably anticipated intermittent, renewable resources, and consideration of the spinning reserves (or operating reserves) to reasonably accommodate such resources and maintain service reliability. Therefore, the target heat rate is set by design to accommodate intermittent, renewable resources. Furthermore, it should be pointed out that the disincentive to add intermittent, renewable resources has already been mitigated by other requirements, which creates the need for the HECO Companies to add renewable resources, intermittent or not, in order to avoid violating or reneging on those commitments.[33]

The process of developing a target heat rate provides a benchmark against which the HECO Companies' performance can be measured. Inevitably, curtailments of intermittent, renewable resources will occur and disputes regarding the HECO Companies' performance and actions to accommodate and integrate such resources will rise, regardless of the ECAC implemented by the Commission in this proceeding. Undoubtedly, the Commission and Consumer Advocate will be advised of such curtailments, and the affected parties will share concerns. In these situations, the Commission and Consumer Advocate will be able to benchmark the HECO Companies' actual spinning reserves (or operating reserves) and other performance factors during such situations, against that used in the investigations and analysis to develop the target heat rate for each of the HECO Companies. This could provide the Commission and the Consumer Advocate a benchmark and basis for evaluating and resolving such disputes regarding the performance of each company to accommodate intermittent, renewable resources. Under a full pass through mechanism, the Commission and

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33 See, e.g., HRS § 269-92 and the Energy Agreement.

Consumer Advocate will be lacking such information and analysis of reasonable, expected performance to accommodate intermittent, renewable resources for dispute resolution and prudence reviews.

HDA argues a full pass through mechanism is considerably simpler to administer, and that the ECAC calculation involving a fixed heat rate with the deadband adds complexity to the ECAC calculation. If HDA is referring to the monthly ECAC calculation, it may be true that a full pass through mechanism may require a smaller spreadsheet with fewer lines than the current ECAC spreadsheet with the fixed heat rate. Likewise, with regards to complexity, a full pass through mechanism may be easier and quicker to explain than the ECAC calculation with the fixed heat rate, especially if a deadband is added to the calculation. The monthly ECAC calculation with the fixed heat rate, even with the addition of the deadband, however, can not be suggested to be challenging, burdensome or difficult to verify especially considering that the current ECAC with the fixed heat rate has been in effect for a number of years.

It is not clear to the Consumer Advocate, however, how a full pass through mechanism would be simpler and less complex that the current ECAC practice involving a fixed heat rate. Under the current ECAC, a heat rate target is determined during the discovery, investigative process of a rate case filing. Production simulation modeling and analysis are performed, and a target heat rate is established for the ECAC calculation. The ECAC with the fixed heat rate, and the deadband, remain in effect until the Commission's decision and order in the next rate case filing.[34] In between rate case filings, the inputs to the monthly ECAC calculation are limited and easily verifiable.

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34 Under the joint HECO and Consumer Advocate proposal, triggers are established for updating the target heat rate between rate case filings when large resources are added.

Because of the use of a fixed heat rate, the Commission and Consumer Advocate have not found it necessary to conduct extensive reviews and audits as found in some other jurisdictions.

On the other hand, were the Commission to adopt the Other Parties' full pass through mechanism, the Commission and Consumer Advocate will need to consider the additional reporting requirements, auditing process and frequency, investigations, reviews, etc. to provide the due diligence and comfort that the HECO Companies' performance, and revenues collected through the full pass through mechanism, were reasonable and prudent. While the current ECAC does this only at every rate case filing, the due diligence would have to investigate continuously, every year, the pass through mechanism's revenue collections. Also, whereas the current ECAC provides optimum performance incentives for the HECO Companies, the full pass through mechanism would not likely establish a reasonable standard for performance for the HECO Companies. As stated above, as a practical matter it would likely never be known, nor will the Commission or Consumer Advocate be in a position to establish, whether full pass through costs could have been lower as a result of performance risks being shifted from the HECO Companies to the ratepayers.

Finally, DBEDT suggests that if the fixed heat rate is retained in the ECAC calculation, the fixed heat rate should be modified from the current sales level heat rate to a generation level heat rate. The difference between the current sales level heat rate and the generation level heat rate are the losses and unaccounted for energy representing the difference between output of the energy produced by the generators, and the energy metered and used at the customers' location. The movement and delivery of electricity from the generators through the transmission and distribution systems to the customers' meters requires energy to be used for line and transformer resistance and impedances. This energy use, referred to as energy losses, is a naturally occurring phenomenon subject to the law of physics that cannot be ordered differently by the Commission or controlled by discretion of the HECO Companies' management.

Establishing a heat rate for purposes of ECAC calculation is based on modeling and analysis that represents what is reasonably and prudently achievable by the HECO Companies for the test year conditions. Excluding energy losses and unaccounted for energy from the heat rate calculation as proposed by DBEDT, results in a heat rate that cannot reasonably be achieved by the HECO Companies and therefore can only be viewed as being punitive. In fact, the only apparent opportunity for the HECO Companies to achieve the target heat rate proposed by DBEDT would be to reduce the amounts for spinning reserves (or regulating reserves) needed to accommodate and integrate variable or intermittent renewable resources. This is in direct contradiction of the ECAC position stated elsewhere in DBEDT's opening brief.

DBEDT does not offer any explanation or analysis that the exclusion of energy for losses and unaccounted for energy can produce a heat rate target that is reasonably achievable by the HECO Companies; nor does DBEBT provide a basis for finding that the target heat rate for the ECAC calculation should be set to be punitive. In addition, as indicated above, DBEDT's proposal would provide a greater disincentive for the HECO Companies to carry higher spinning reserves (or operating reserves), which is necessary to accommodate the addition of more intermittent, renewable energy.

Historically, the fixed heat rate established by the Commission to be used in the ECAC calculation has always included the consideration and allowance for energy for losses and unaccounted for energy and DBEDT has not demonstrated good reason for the Commission to do otherwise.[35]

V. HECO ALTERNATIVE RBA/RAM PROVISIONS NOT IN THE JFSOP.

In its opening brief, the HECO Companies submitted several alternatives to the JFSOP for the Commission's consideration. It is the Consumer Advocate's understanding that these changes were proposed by the HECO Companies in response to the questions and apparent concerns of the Commission communicated by way of discovery or questions during the panel hearing. The Consumer Advocate was advised of these changes prior to the filing of HECO's opening brief, but had no reasonable opportunity to fully consider and respond to these changes prior to the submission of opening briefs. Subsequent to the opening briefs, additional discussion on these revisions occurred.[36] Our response is set forth in this section of the Consumer Advocate's Reply Brief. The new alternatives to the JFSOP that are now suggested as acceptable to the HECO Companies include:

- As an alternative to the separate Residential and Commercial RBA sub-accounts provided for in the JFSOP, HECO has indicated that a

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35 Assuming arguendo that DBEDT's proposal is to encourage the movement away from central station generation to distributed generation, where the level of energy losses and unaccounted for energy may decrease, DBEDT has not offered any analysis that supports such an assumption or proposal. Without such evidence and lacking even the underlying argument clearly presented in the record, the Commission should attach the appropriate weight to this proposal.

36 Conference calls were held and documents were exchanged with the HECO Companies to discuss and explore the newly-proposed revisions to the JFSOP.

single Company-wide RBA account for all customers of each utility would be acceptable, where the administrative simplification of a single large RBA account and the opportunity to more broadly spread any loss of sales from a single large customer may outweigh the JFSOP benefits of not mixing the revenue responsibility assignments between residential and commercial classes that was established in the most recent rate case.[37]

- HECO would "expand the rate base RAM language to state that the Companies will refund (with interest) RAM revenues associated with disallowed costs for baseline projects" so as to appropriately eliminate the possibility of improperly retaining revenues associated with any capitalized plant assets subsequently disallowed by the Commission.[38]
- A *Service Reliability Benchmark based upon a System Average* Interruption Duration Index ("SAIDI") benchmark, through which the HECO Companies would credit customers, through the RBA balance accounting, whenever normalized SAIDI exceeds the average SAIDI experience of each Company over the past five years (2004-2008). The credits would be based upon four times the average margin revenue per minute collected by each utility, multiplied by the SAIDI excess over the benchmark, plus any actual revenues foregone during major outages where HECO was found responsible for the outage.[39]

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37 HECO Companies opening brief; pp. 93-94.

38 Id. p. 97.

39 Id. pp. 86-89.

- HECO is "also willing to revise the rate base RAM component for major (i.e., General Order No. 7 ("G.O.7") projects) to include only the cost estimate for each project authorized in the G.O.7 proceeding...until a project's actual cost is reviewed in a rate case...[and] to address any concern with respect to whether projects have actually gone into service, the rate base RAM would be updated on a quarterly basis to recover costs for major projects that are placed into service in earlier quarters."[40] This alternative proposal would expand the filing and review of rate base RAM calculations (for major projects only) from the annual filing contemplated in the JFSOP to as many as four quarterly filings and rate changes per company.

The Consumer Advocate's response to these new alternative RBA/RAM provisions that deviate from our JFSOP with the HECO Companies is that <u>we have no objection to the first two items listed</u> above; the single RBA account and Company-wide decoupling ratemaking procedures, and the refunds for non-major capital projected included in RAM, but later disallowed by the Commission.

Regarding the third alternative proposal, the proposed new SAIDI-based service reliability penalties, we do not object to the utilization of this measure for the initial decoupling term, subject to more detailed analysis of service quality metrics and achievement standards in future proceedings. The Consumer Advocate's desire to leave open the issue of the appropriate service quality metric or metrics for further discussion is based on experience in other dockets. For instance, in Docket

40 Id. p. 98.

No. 04-0131, HECO sought Commission approval to install an outage management system ("OMS"). As part of that docket, HECO disclosed that its service quality reports relied upon records that were often based upon after-the-fact estimations. The various disclosures in that discovery response suggest that the service quality record keeping practices may not have provided entirely accurate and reliable results (see CA-SIR-9 in Docket No. 04-0131). While it is assumed that the OMS will be able to provide reliable service quality metrics, the Consumer Advocate would like to reserve the ability to revisit the relationship between the proposed use of SAIDI as the correct (and only) index to use as part of the RAM determination as compared to other service quality or customer service metrics.

For the fourth alternative, the Consumer Advocate does not support quarterly filings and updates to RAM and the additional administrative burdens associated with more filings unless broader simplification of the rate base RAM is made a part of the quarterly updates. In the JFSOP, the rate base RAM is to be calculated annually, using a two-point average calculation of Plant in Service, Accumulated Depreciation, Accumulated Deferred Income Taxes and Contributions in Aid of Construction ("CIAC") for the prospective year, compared to the last approved level of these rate base elements. Per book recorded values at the previous calendar year-end serve as the initial data point for the two-point average, while projected values for baseline and major Plant additions must be developed and added to the recorded book values to estimate year-end Plant.[41] For the Major additions to Plant in Service, the new HECO Companies' alternative would no longer include projected costs for major projects

[41] These terms are set forth in the RAM Tariff at section 2(f), included as JFSOP Exhibit B-1.

expected to be completed within the first nine months of the RAM year, but would instead update for the actual cost of major additions actually completed during each quarter of the RAM year.[42] This updating process would entail new RAM filings, workpapers and review obligations every calendar quarter for the major projects.

The Consumer Advocate submits that, if the Commission accepts this new alternative and burdens the decoupling process with quarterly filings, the rate base RAM should also be further simplified by eliminating all of the estimated RAM year values, instead using the available actual recorded quarterly book values for Plant in Service, Accumulated Depreciation, CIAC and Accumulated Deferred Taxes, in place of estimates, in calculating the second part of the two-point average values. This quarterly recalculation of the average rate base with actual values could massively simplify the rate base RAM by avoiding the need for calculations of historical five-year average baseline plant additions and CIAC, engineering estimates of CIAC on major additions, and the estimation of deferred tax effects for depreciation timing differences. While the *Consumer Advocate still supports RAM as defined and proposed in the JFSOP*, the Consumer Advocate commits to work with HECO to modify and conform the RAM Tariff in the event the Commission accepts the alternative that would require submission of quarterly filings and is not supportive of quarterly filings and quarterly rate base RAM adjustments in the absence of such simplification.

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42 The "actual costs" would be limited to not exceed cost levels approved by the Commission in any related G.O. 7 proceedings.

VI. CONTINUATION OF THIS DOCKET.

HDA (and HSEA by Joinder) has proposed that the Commission issue an interim decision that approves the RBA provision for use by the HECO Companies, but that approves the RAM and modifications to the ECAC only on a "one year pilot implementation" basis, so that the instant Docket can remain open for further consideration of RAM extension and any other "alternatives, allocation methods, safeguard provisions and/or incentive mechanisms."[43] HDA generally recommends "continuation of this proceeding" for many purposes, including:

- Examination of potential improvements in Hawaii's ratemaking procedures and protocols.[44]
- Further examination of appropriate performance measures related to the HCEI Agreement.[45]
- *To allow the Commission more information and time to make any final* determinations.[46]
- To conduct a "rate impact assessment."[47]
- To make RAM continuation contingent upon adherence to a three-year rate case cycle.[48]

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43 HDA opening brief; pp. 7-9. See also HSEA's Joinder to Blue Planet Foundation's Post-Hearing opening brief.

44 Id. p. 17.

45 Id. p. 21 and p. 39.

46 Id. p. 22.

47 Id.

48 Id. p. 39, p. 43.

- To consider a force majeure or "z-factor" mechanism.[49]
- For the development of a "draft master plan" with forecasted financial results.[50]
- To consider the impact of Commission decisions in other dockets, such as feed-in tariffs, REIS, IRP, etc.).[51]

While the Consumer Advocate may support some of the objectives identified above, the Consumer Advocate does not support indefinite continuation of this Docket. It is recognized that decoupling concepts and the RBA/RAM proposals within the JFSOP are new and challenging issues not previously considered by the Commission. The issues and concerns raised by HDA and the other parties have been thoroughly addressed in this Docket, through the conduct of multiple filings of draft and final statements of position, responses to discovery from the parties and the Commission's consultants as well as vigorous discussions in the panel hearings. No party, including the Consumer Advocate or the HECO Companies, can expect the financial outcomes from RBA and RAM implementation to be predictable with any certainty. Indeed, the risk of imprecise specification of the decoupling plan is what motivated the Consumer Advocate to insist upon a conservatively designed RAM tariff that is administratively workable and that is backstopped with several consumer safeguards, including earnings sharing and a near-term comprehensive review in the next HECO rate case.[52]

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49 Id.

50 Id. pp. 39-40.

51 Id. p. 42.

52 See "Consumer Safeguards" in the Consumer Advocate Opening Brief at pp. 32-33.

The remaining issues of concern to HDA and other parties to this Docket are shared by the Consumer Advocate and, to the extent these issues are not specifically resolved by a final order of the Commission, the Consumer Advocate intends to examine them as part of the scheduled next review of decoupling, but this does not require the instant proceeding to remain open indefinitely.

DBEDT has not proposed continuation of this Docket, but instead recommends that the Commission's approval of decoupling must remain subject to "...periodic review by the Commission and allowing for termination by the Commission at any time as deemed appropriate."[53] This recommendation is entirely consistent with the structure of the decoupling mechanism set forth in the JFSOP of the Consumer Advocate and the HECO Companies. The Consumer Advocate submits that the most appropriate forum for review of the RAM mechanism is within the next HECO rate case, when more will be known about progress toward implementation of the HCEI Agreement provisions, resolution of the various related Dockets before the Commission, service quality, customer impacts as well as the financial performance and financial condition of the utilities at that time.

VII. CONCLUSION AND RECOMMENDATIONS.

The Consumer Advocate appreciates the substantial efforts and thoughtful recommendations of the Parties in this Docket and acknowledges that the proposed decoupling mechanism, in the form of the revised RBA and RAM tariffs set forth in the JFSOP (as amended), has been substantially shaped and improved by the collective

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53 DBEDT opening brief; p. 55.

input from all Parties. The record in this Docket is complete with respect to the relevant issues that should be initially considered by the Commission. The opening briefs of the Parties are supportive of the decoupling approach and generally accepting of the terms of the JFSOP, even where variations, limitations and appendages to those terms have been proposed by the Parties. For the reasons stated in the FJSOP and explained during the panel hearings, and reiterated in the Consumer Advocate's Opening Brief and this Reply Brief, the Commission should approve the RBA and RAM in the form proposed in the JFSOP (as amended) in an Order closing this Docket.

Further consideration of decoupling modification, limitation, performance linkages and other matters is best undertaken in the context of the expected 2011 HECO rate case. At that time, the Consumer Advocate welcomes participation by all concerned parties in a phase of that proceeding that should be specifically designated for decoupling review, at which time more refined expectations regarding RPS and Energy Agreement objectives, more experience with financial outcomes from RBA and RAM, and an updated set of cost of service and pricing information will be available to guide further Commission action.

DATED: Honolulu, Hawaii, September 29, 2009.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing **DIVISION OF CONSUMER ADVOCACY'S POST-HEARING REPLY BRIEF** was duly served upon the following parties, by personal service, hand delivery, and/or U.S. mail, postage prepaid, and properly addressed pursuant to HAR § 6-61-21(d).

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